

# Getting to Zero Iranian Oil Exports

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Brief Analysis

## The world oil market will be the most sensitive indicator of how increased sanctions affect Iran.

President Trump's strategy of pressuring Iran is based on an important premise—that there is enough spare oil production capacity elsewhere in the world to make up for lost Iranian supplies without causing an undesirable price increase. In particular, Saudi Arabia is expected to boost production to cover most of the shortfall. While this expectation seems reasonable, the plethora of moving parts makes predicting the exact outcome difficult.

National Security Advisor John Bolton seemed to hint at these complexities during an October 31 event at the Alexander Hamilton Society, where he noted that the administration's aim was to affect Tehran, not the countries that depend on its oil: "We want to achieve maximum pressure but don't want to harm friends and allies." He also struck a conciliatory tone by acknowledging that some countries "may not be able to go all the way to zero immediately."

## PRESSING IRAN'S BUYERS

The tactic of convincing Tehran's principal oil customers to buy elsewhere has had only mixed success. While Japan and South Korea have ceased buying Iranian oil, India, China, and Turkey reportedly believe that global supplies are not sufficient to replace their purchases. Naturally, most refiners prefer maintaining long-running supply relationships, and many of them are optimized to use particular types of crude.

Going forward, Washington may offer limited oil-purchase waivers on two conditions: that the resultant revenues are deposited into escrow accounts, and that Iran is prohibited from using this money except for carefully defined humanitarian purposes, at least until additional supplies become available from Saudi Arabia and Russia in mid-

2019. The real target, then, is achieving zero export revenues, not ending all oil exports. This can be accomplished through a variety of limited measures—for example, if India paid for Iranian oil supplies in rupees, the revenue would be far less useful to Tehran than dollar payments, the usual currency for such purchases.

Although Beijing is not expected to cooperate with the United States, it is sending conflicting signals. On October 24, Reuters reported that the two top Chinese state-owned refiners had not committed to loading Iranian oil in November because of concerns they would be violating U.S. sanctions. However, a day later, reports surfaced that Iran planned to supply more than 20 million barrels to the Chinese port of Dalian in October and November—a sharp increase from the usual monthly volumes. Market wisdom suggests that China will continue to buy around 1 million barrels per day (b/d) of Iranian oil, but also drive a hard bargain with Tehran by insisting on discount prices.

## AVOIDING PRICE SPIKES

**T**he benchmark Brent crude reached a four-year high of \$86 per barrel in early October but slid down to \$76 within three weeks due to fears that demand may fall. This week, it dropped again to \$74 per barrel.

Meanwhile, Bloomberg reported that OPEC signaled it may cut output in 2019. Together with Russia, the cartel is trying “to prevent the market [from] slipping back into imbalance” by preparing “options” for how much oil to produce next year. This is code for lower prices, which is good news for consumers but bad news for producing countries trying to fund their national budgets. As such, many governments were displeased by President Trump’s recent call for OPEC to raise production in order to lower prices.

## THE KHASHOGGI EFFECT

**T**he ongoing controversy regarding the murder of Saudi dissident journalist Jamal Khashoggi could significantly affect the kingdom's calculus. Despite supporting increased sanctions on Iran, Riyadh had been “slow-walking” promised production increases, in the words of Politico. Saudi leaders may now be changing their tune in order to prevent the White House from directly blaming them for the murder.

If Congress **tries to restrict arms sales (<https://www.washingtoninstitute.org/policy-analysis/view/u.s.-must-impose-a-price-on-saudis-but-one-with-a-clear-purpose>)** to the kingdom, however, Riyadh’s commitment to pump oil may shift once again. Current production sits at around 10.5 million b/d, but experts believe it could easily reach 11 million (though they cast doubt on Riyadh’s aspiration to hit 12 million).

## UNCERTAINTY ABOUT OTHER PRODUCERS

**D**espite the unpredictable output of Venezuela, Libya, and Nigeria, the current oil market is surprisingly stable. Yet adding Iran, one of OPEC’s leading producers, to this mix could make the situation more volatile. Tehran already lost 1.2 million b/d of production between March and September. While Russia remains a wildcard, it is unlikely to do any favors for the United States if Iranian supplies continue to dwindle.

As for the growing volume of American shale oil, it is unlikely to have a decisive policy impact in the near term. Wells in the Permian Basin produced 3.5 million b/d in October, but sustained production is technically challenging, and confidence in significant increases is still low. This picture may change somewhat in 2019, when the resolution of certain pipeline constraints could allow for another 1 million b/d in production. Ultimately, however, the United States will remain a net importer of oil.

## CONCLUSION

**A**lthough the scene is set for at least an initial American victory on constraining Iran’s oil exports, the advantage needs to be sustained over several weeks and perhaps months if it is to force concessions from Tehran. Predicting oil market trends beyond the very short term is a fool’s game given the commodity’s ease of

transportation compared with other energy sources. Thus, while financial sanctions should help squeeze Iran's ability to finance a whole range of imports, cutting oil revenues is no sure bet.

In the worst-case scenario, oil price increases will compensate for production cuts, dulling or even eliminating the effect on Tehran's revenues. At the same time, economic hardship will only get worse for the Iranian people. European governments opposed to the Trump administration's approach are preparing to implement a so-called Special Purpose Vehicle to keep bilateral trade going, with uncertain implications for U.S. sanctions.

In the end, Tehran's willingness to change its behavior and negotiate on nuclear, missile, and regional issues likely depends on a range of sustained pressures. Oil is the most obvious pressure point—but also the most likely to produce unintended consequences elsewhere.

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